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CITATIONS

In the Supreme Court of the United States

October Term, 1947

No. —

Commissioner of Internal Revenue, petitioner

v.

Allan S. Lehman

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 3–26) is reported at 7 T. C. 1088. The opinion of the Circuit Court of Appeals (R. 32–38) is reported at 165 F. 2d 383.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 5, 1948. (R. 40.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. The taxpayer is a member of a partnership which, at various times, had acquired certain assets that had since appreciated in value. Upon the admission of new partners to the firm in 1937, the taxpayer's capital account and percentage interest in the firm were reduced, this being accomplished by cash withdrawals from the firm, and by the receipt of payments from the incoming partners based on the appreciated assets.

The question is whether the court below could properly hold that the gain which was realized by the taxpayer resulted from a sale of a portion of an interest in the partnership which was a capital asset, the portion of the gain to be taken into account under Section 117 (a) of the Revenue Act of 1936 being dependent on the time that this interest was held, or whether, as the Commissioner contends, the only possible subject matter of the sale under the taxing statute was a partial interest in the specific assets of the partnership, the holding periods to be determined by the time that each asset was held.

2. One of the members of the firm had died less than one year prior to the time that the new partners were admitted. The surviving partners, as they were entitled to do under the partnership agreement, continued the business.

The second question is whether, if the taxpayer did sell an interest in the partnership which could be regarded as a capital asset, the court below

could properly rule that this interest was held for more than 10 years despite intervening changes in the firm.

3. The taxpayer's dollar investment and percentage interest in the firm, even after the admission of the new partners, were greater than they were 10 years previously, they having been increased subsequent to taxpayer's initial admission to the predecessor partnership by additions to his capital account.

The third question is whether, if the taxpayer did sell an interest in the partnership which could be regarded as a capital asset, the court below could properly hold that the interest was identified as having been held for more than 10 years despite the intervening changes in his interest in the firm.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Regulations involved are set forth in the Appendix, *infra*, pp. 17–21.

STATEMENT

The taxpayer, Allan S. Lehman, is an individual residing at Tarrytown, New York. The tax return for the calendar year 1937 was prepared and filed on the cash basis. (R. 5.)

Lehman Brothers is a copartnership engaged in a general financial, investment, and brokerage business. The partners have from time to time changed, some partners having died or withdrawn

and some new persons having been admitted as partners. (R. 5–6.)

Taxpayer became a partner in 1908 upon the acquisition of a capital interest of $500,000, and his capital account and interest fluctuated between that date and December 31, 1925, by reason of various cash withdrawals from and contributions to partnership capital. As of December 31, 1925, his capital account in the partnership as then constituted was $1,035,710.59, which represented a 14.99 per cent interest in the partnership. Thereafter, from December 31, 1925, until December 31, 1935, his capital account and his percentage interest with relation to the total capital of the partnership fluctuated, by reason of withdrawals and additions to capital by the taxpayer and the other partners, from approximately 13 per cent to approximately 22 per cent. Subsequent to December 31, 1925, his capital was not less than $1,035,710.59 and his percentage interest in the partnership as constituted at any time was not less than 13.425 per cent. (R. 6.)

As of January 1, 1936, the partners signed a new partnership agreement with themselves and one Edward J. Bermingham, under which Bermingham was admitted to membership in the partnership as a capital partner. The total capital account under the new agreement was $12,500,000, the taxpayer's capital account was $2,381,250, and his percentage interest was 19.05 per cent. No change in the capital accounts of

the partners occurred thereafter prior to the death of Arthur Lehman, one of the partners, on May 16, 1936. (R. 7.)

On May 16, 1936, Arthur Lehman died and in accordance with the provisions of the partnership agreement dated January 1, 1936, the interest of the decedent was continued in the firm until June 30, 1936. As of July 1, 1936, the capital account of the decedent was transferred on the books of the partnership to an account payable to his estate. By reason of the transfer the total capital of the partnership was reduced from $12,500,000 to $10,118,750, where it remained through December 31, 1936. The liability of the firm to the estate of the deceased partner was thereafter liquidated in accordance with the terms of the partnership agreement. The partnership agreement drawn January 1, 1936, provided that the partnership should be continued if partners having together more than 50 per cent of the capital of the partnership should so determine. The remaining partners, having more than 50 per cent of the capital of the partnership, determined to continue in partnership with the surviving partners and they continued in business through December 31, 1936. (R. 7–8.)

Upon changes in the partnership personnel and their capital accounts during the period 1925 to 1937, new partnership agreements were executed. Such changes had no effect on the partnership business. The business was not formally

terminated, but continued in the same manner and under the same firm name throughout this period. The books and records of the partnership were not formally closed after such changes in personnel and interests, but adjustments were made in the appropriate accounts. Outstanding underwriting contracts and other agreements of the firm in connection with its investment banking business continued unchanged. (R. 8.)

On January 1, 1937, upon the admission of certain new capital partners, the continuing partners and the new capital partners signed a new partnership agreement. The total capital account was $10,000,000, the taxpayer's capital account was $2,008,000, and his percentage interest was 20.08 per cent. (R. 8–9.)

The reduction in the partnership capital from $10,118,750 as of December 31, 1936, as set out above, to $10,000,000 as of January 1, 1937, was effected on January 1, 1937, by actual withdrawals in cash and charges to the respective capital accounts of certain other continuing partners. (R. 9–10.)

As of January 1, 1937, on the admission of new capital partners to Lehman Brothers, the taxpayer, Robert Lehman, Philip Lehman, and John D. Hertz each sold a fractional part of his property rights in the partnership to one of the continuing partners, Edward J. Bermingham, and to the five new capital partners, John M. Hancock, Paul M. Mazur, William J. Hammerslough,

Thomas H. Hitchcock, Jr., and Joseph A. Thomas. The property rights sold by the taxpayer to the buying partners constituted a fractional share of his interest in the partnership. The selling partners made actual cash withdrawals from the partnership of the amounts of the reduction in their capital accounts from that set forth in the partnership agreement on January 1, 1936 (but after the reduction in capital of $118,750 described above), and the amounts of their capital accounts provided for in the new partnership agreement dated January 1, 1947. At the same time the buying partners contributed to the partnership the amount of their capital account as provided for in the partnership agreement. (R. 10.)

As of January 2, 1937, and as a part of the same transaction, each of the buying partners caused a letter to be sent to the partnership confirming his understanding of the transaction and agreeing to pay to the selling partners in proportion to their interest in the capital of the firm on December 31, 1936, an amount equal to a certain percentage of the excess over cost on its books of the value of the assets of the firm on December 31, 1936, after such assets had been valued by the partners holding more than 50 per cent of the capital of the partnership. (R. 10–11.)

Under the transaction the buying partners made certain payments (in excess of their capital

contributions) to the selling partners and the selling partners received certain amounts as withdrawals in capital and payments by the buying partners. The taxpayer received $448,411.88, a reduction in capital of $345,000, and an excess over reduction in capital account of $103,411.88. The cost or other basis of the interest which the taxpayer sold was $345,000. The gain on the sale (by reason of certain adjustments made between the selling partners including the taxpayer) was $99,899.58. (R. 11.)

The taxpayer executed no bill of sale with respect to any specific assets of the partnership or any other document, other than the January 1, 1937, partnership agreement. The partnership assets were at all times during the transaction carried in the partnership name and on its books on the basis of cost, and the books did not reflect any fluctuations in the value of these assets. (R. 11-12.)

The Tax Court, two members dissenting, held (1) that the holding period of the fractional partnership interest sold should be measured from the date of the acquisition in 1908 by the taxpayer of his partnership interest and not from the date or dates of acquisition by the partnership of the specific partnership assets; (2) that the death on May 16, 1936, of Arthur Lehman, did not dissolve the partnership or reduce the holding period of the fractional partnership interest sold on January 1, 1937, to less than one year;

and (3) that the fractional partnership interest sold had been identified as held over 10 years and only 30 per cent of the gain was taxable. (R. 12–25.)

The Circuit Court of Appeals affirmed the decision of the Tax Court.

SPECIFICATIONS OF ERRORS TO BE URGED

The court below erred in holding that the taxpayer had sold a portion of his interest in a partnership which, without regard to the nature of the partnership assets and the length of time that they were held, was a capital asset, and that it had been held for more than 10 years so that only 30 per cent of the realized gain was required to be taken into account in the computation of net income under Section 117 (a) of the Internal Revenue Code.

REASONS FOR GRANTING THE WRIT

The taxpayer was a member of a partnership which was engaged in the general investment and brokerage business. On January 1, 1937, certain new capital partners were admitted to the firm and the capital account of one of the former partners was increased. Their capital contributions did not serve to increase the total capital of the business, for the taxpayer and the remaining partners had their capital accounts reduced and each made a cash withdrawal from the firm. At the time that these changes in the partnership took place, there were certain partnership assets

which had appreciated in value over their cost. In accordance with an agreement to that effect, each of the buying partners paid to the selling partners (including the taxpayer) certain amounts on account of this appreciation in value. These assets had been held by the firm for varying periods of time. The court below decided that the taxpayer did not sell an interest in these appreciated assets to the buying partners, but that he sold a portion of an interest in the partnership which, itself, was a capital asset and that, in determining the portion of gain to be taken into account under Section 117 of the Revenue Act of 1936, Appendix, *infra,* the holding period was to be measured from the time that his partnership interest was acquired rather than in relation to the length of time that the appreciated assets had been held by the firm. It further held that, despite the changes in the structure of the firm during the intervening years, the taxpayer's partnership interest had been held for more than 10 years.

1. The decision below is in direct conflict with that of the Court of Claims in *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98, where it was decided that the holding period relates to the specific partnership assets and not to the time that the selling partner held his so-called partnership interest. The court below recognized (R. 36) that the *City Bank*

Farmers Trust Co. case was directly opposed to its decision but declined to follow it, preferring, instead, to decide the issue here in harmony with the rule adopted by the Circuit Court of Appeals for the Third Circuit in *Thornley v. Commissioner,* 147 F. 2d 416.

2. The decision below is erroneous in holding that a partner has a property right in the partnership business which is distinct from his interest in the partnership assets and which may be the subject matter of a taxable transfer. Actually, the taxing statute does not recognize that such a property right exists. On the contrary, in taxing the partners on their distributive share of the partnership net income without regard to whether the firm profits are withdrawn or remain invested in the business (Sections 181–183 of the Revenue Act of 1936, Appendix, *infra*) and in considering that taxable transactions do not occur either when assets are contributed by the partners to the firm or when partnership property is distributed by the firm to its members proportionately (Section 113 (a) (13), Revenue Act of 1936, Appendix, *infra*; Articles 113 (a) (13)-1 and 113 (a) (13)-2, Treasury Regulations 94, Appendix, *infra*), the 1936 Act and previous revenue acts have been framed generally on the theory that the partners are co-owners of the business assets; the statutes have not recognized any separate property interests in the business, as such, which would be the

subject matter of gain or loss. See Sol. Op. 42, 3 Cum. Bull. 61 (1920), interpreting the provisions of the Revenue Act of 1916; G. C. M. 10092, XI-1 Cum. Bull. 114 (1932).

In holding to the contrary, the court below relied heavily on the peculiar and limited nature under local law of a partner's rights respecting the specific partnership assets and on the conclusion that his ultimate interest in the partnership was really in " 'his share of the profits and surplus.' " (R. 35.) It concluded that the latter right could be sold at a taxable gain or loss, but recognized that the same conclusion could not be reached "in the case of joint owners who are not partners." (R. 34.) However, the taxing statute cannot be construed to accommodate any special peculiarities of partnerships, for the members of other business organizations (syndicates, groups, pools, joint ventures and other unincorporated organizations which are not taxable as trusts, estates or corporations) are taxable in the same manner as are members of a business organization which qualifies as a partnership under local law. Section 1001 (a) (3) of the Revenue Act of 1936, Appendix, *infra.* Accordingly, since Congress intended to fit all these organizations into a uniform scheme, it did not intend that matters peculiar under local law to any particular organization should have any tax significance. The one aspect of these business organizations which is common to all relates to

the co-ownership of the business property by the members. It is this co-ownership which is the general key to the statutory pattern for taxing gains on partnership property to the partners. *Neuberger* v. *Commissioner,* 311 U. S. 83; Rabkin and Johnson, The Partnership Under the Federal Tax Laws, 55 Harv. L. Rev. 909 (1942).

Upon analysis of what the court below called the taxpayer's interest in the firm profits, it must appear that the only conceivable right which the decision holds was sold by the taxpayer at a taxable gain was related to the appreciation in value of the existing firm assets. The possibility of future profits, disassociated from any specific assets of the firm, was not the subject matter of sale here and could not be, absent the sale of any partnership intangibles, such as goodwill. In cases where good will is sold, there would still be a sale of a partnership asset. Past profits, which would have been taxed to the partners as earned, could not have been the source of additional gain except as they were reinvested in firm assets. As a result, there is no basis for holding that the taxpayer could realize taxable gain completely disassociated from a transfer of a portion of his interest in existing firm assets. To rule, as the court did, that the appreciation in value of those assets would be taxable to the taxpayer without any accompanying changes in his relationship to those assets would be contrary to accepted principles regarding the time when

realization occurs (cf. *United States* v. *Safety Car Heating & Lighting Co.*, 297 U. S. 88, 99) and regarding the taxation of income in the future to the proper owner of the income producing property (*Harrison* v. *Schaffner*, 312 U. S. 579; *Blair v. Commissioner*, 300 U. S. 5). Actually, in the present case, the admitted gain which the taxpayer did realize by the cash received from the firm and from the purchasing partners can only be related to the dilution of his interest in the appreciated firm assets and to a corresponding increase in the interests of others. The payments which the purchasing partners in this case made to the other partners (including the taxpayer) were directly related to the interests which they acquired in these appreciated assets. Whether this was a technical sale of partnership assets as between the partners under local law (cf. *Burnet* v. *Harmel*, 287 U. S. 103) is not of controlling significance, since, for tax purposes, there was a sufficient change in the taxpayer's interest in those assets to result in realization of gain at that point; the nature of what was transferred cannot be obscured by synthesizing this appreciation into a concept of an interest in profits still to be earned by a business group which is not a taxable entity.

As a result, in deciding that the holding period here for determining gain under Section 117 was measured by the length of time that the taxpayer was a partner rather than by the length of time

that he had an interest in the appreciated assets which were the generating source of the gain, the court below was in error.

3. The issue is one of importance in the administration of the revenue laws. In the present case the decision requires that the gain be calculated on the supposition that the subject matter of the sale had been held by the taxpayer for one period, while a substantial part of the underlying assets, having been held for a lesser period, would have resulted in a larger portion of taxable gain had there been a disposition of an interest in them. Likewise, the holding below might be sufficiently broad to compel the conclusion that a sale of a partnership interest would be a sale of a capital asset even though the assets used in the business are non-capital in nature. See the decisions of the Tax Court so holding: *Long* v. *Commissioner,* decided March 29, 1947 (1947 P-H T. C. Memorandum Decisions Service, par. 47,155) (pending on cross petitions for review in the Circuit Court of Appeals for the Fifth Circuit); *Estate of Gartling* v. *Commissioner,* decided July 28, 1947 (1947 P-H T. C. Memorandum Decisions Service, par. 47,213) (pending on petition for review in the Circuit Court of Appeals for the Ninth Circuit); *Smith* v. *Commissioner,* 10 T. C. No. 49; and *Humphrey* v. *Commissioner,* 32 B. T. A. 280 (non-aquiescence XIV–2 Cum. Bull. 34 (1935)). These decisions, and the present case, in principle, are

out of harmony with the decision in *Doyle* v. *Commissioner*, 102 F. 2d 86 (C. C. A. 4th).

4. If the petition for a writ of certiorari is granted, we believe that its scope should not be limited and that this Court should review the alternative matters decided by the court below, namely, whether the holding period of the taxpayer's partnership interest is affected by prior changes in the partnership resulting from the death of a partner, and whether the taxpayer can be considered as having sold a partnership interest which was held for more than 10 years when his dollar investment and percentage interest in the firm, after the admission of the new partners, were greater than they were 10 years previously. If the court below should be sustained on the principal issue, it will be important that these alternative questions be decided. Thus, in ruling that the taxpayer sold a partnership interest which he held for more than 10 years solely because he was a member of successive firms for that length of time, and despite the fact that he continued to possess a greater investment after the sale than he did 10 years previously, the court below may have suggested an important avenue of tax avoidance, the correctness of which ought to be reviewed.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

PHILIP B. PERLMAN,
Solicitor General.

APRIL 1948.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(13) *Partnerships.*—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any of the paragraphs (1) to (12), inclusive, of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

* * * * *

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year.

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual.

SEC. 1001. DEFINITIONS.

(a) When used in this Act—

* * * * *

(3) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this Act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 113 (a) (13)-1. *Property contributed in kind by a partner to a partnership.*—The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation are to be computed on such basis. If such basis is greater than the fair market value of the property at the date of the transfer to the partnership, the annual depletion or depreciation allowances shall be allocated to and included in the determination of the distributive shares of the partners in accordance with their agreement in respect of the sharing of gains or losses affecting partnership capital. If the basis of such contributed property is less than the fair market value thereof at the date of transfer to the partnership, the annual allowances for depletion and depreciation are

to be limited to such basis and may be apportioned among the partners according to their agreement with respect to the sharing of gains or losses affecting partnership capital. On the sale or other disposition of such contributed property by the partnership the gain or loss, determined on such transferred basis, adjusted as required by section 113 (b), shall be prorated in determining the distributive shares of the partners according to their gain or loss ratios on the disposition of a partnership asset under the partnership agreement.

ART. 113 (a) (13)–2. ***Readjustment of partnership interests.***—When a partner retires from a partnership, or the partnership is dissolved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost or other basis as hereinbefore provided and the value of such interest as of such date, plus the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained, and the gain derived or the loss sustained shall be computed as provided in article 111–1. See also section 117. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. The basis of such property in the hands of the partner shall

be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

If a new partner is admitted to the partnership, or an existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain has been realized or loss sustained by any partner.

U. S. GOVERNMENT PRINTING OFFICE: 1948

BRIEF FOR THE RESPONDENT IN OPPOSITION

In The

Supreme Court of the United States

October Term, 1947

No. 720

Commissioner of Internal Revenue,

Petitioner,

v.

Allan S. Lehman

ON PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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The opinion of The Tax Court of the United States (R. 3-26) is reported at 7 T. C. 1088. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 32-38) is reported at 165 F. (2d) 383.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Second Circuit (R. 39) was entered on January 5, 1948. (R. 40) Petition for a writ of certiorari was filed April

5, 1948. The jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. (U. S. C. A., Title 28, section 347 (a))

QUESTIONS PRESENTED

1. When the taxpayer on January 1, 1937 sold a fractional share of his property rights or interest in Lehman Brothers, a co-partnership under New York Law, is the holding period under section 117 (a) of the Revenue Act of 1936 to be measured from the date of acquisition by the taxpayer of the property rights or interest sold, or is such holding period to be measured from the date or dates of the acquisition by the partnership of its specific assets?

2. What effect, if any, did the death of one of the partners of Lehman Brothers on May 16, 1936 have on the holding period of the fractional share of the property rights or partnership interest sold by the taxpayer on January 1, 1937?

3. Was the fractional share of the property rights or partnership interest sold by the taxpayer identified as having been held by him for more than 10 years for the purpose of applying the percentage provisions of section 117 (a) of the Revenue Act of 1936?

STATUTES INVOLVED

The applicable provisions of the statutes involved are set forth in the appendix, *infra*, pp. 15-16.

ARGUMENT

1. The basic question specified by the Government is not in issue before this Court.

The application of section 117 of the Revenue Act of 1936 to the facts in this case requires, in the first instance, the determination of two questions (1) was there a sale or exchange of a capital asset as defined in subsection (b) and (2) how long had the capital asset been held for the purpose of applying the percentages of gain to be taken into account under subsection (a). That these involve separate determinations is shown by Article 117-1 of Regulations 94, which provides that, "In determining whether property is a 'capital asset', the period for which held is immaterial".

The basic error specified by the Government in its petition for certiorari (p. 9) is that, "The court below erred in holding that the taxpayer had sold a portion of his interest in a partnership which, without regard to the nature of the partnership assets and the length of time that they were held, was a capital asset * * *". By that basic specification of error, the Government challenges, and seeks to have this Court review, the correctness of the Commissioner's original determination. In the petition (p. 15), it is asserted that the issue raised is one of importance in the administration of the revenue laws because, "Likewise, the holding below might be sufficiently broad to compel the conclusion that the sale of a partnership interest would be a sale of a capital asset even though the assets used in the business are non-capital in nature". Yet, that is precisely what the Commissioner determined here.

The property of Lehman Brothers on January 1, 1937 consisted both of capital and non-capital assets. (R. 31) In other words, a substantial portion of the specific assets of the firm consisted of securities held "for sale to cus-

tomers in the ordinary course of [its] trade or business", and as such were excluded from the definition of "capital assets" under section 117 (b). The Commissioner in his notice of deficiency determined that what the taxpayer sold on January 1, 1937 was "a fractional interest in Lehman Brothers partnership" and that the entire gain therefrom of $99,899.98 was a capital gain, *i. e.,* gain from the sale of a capital asset. (R. 3-4)[1] That the Commissioner determined that the capital asset sold was an interest in the partnership distinct from the specific partnership assets is conclusively shown by the fact that in computing the capital gain he made no segregation between the capital and non-capital assets.[2] (R. 31, 4) The correctness of his determination in that respect was not questioned by the Government, either in the Tax Court or in the Circuit Court of Appeals. Thus, paraphrasing the Government's basic specification of error here, the Commissioner in his notice of deficiency determined that the taxpayer sold a portion of his interest in a partnership which, without regard to the nature of the partner-

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[1] The pleadings are not included in the record filed by the Government in this Court. They are, however, a part of the record on file with the Circuit Court of Appeals. In paragraph 5 (b) of the petition before the Tax Court, it was alleged that "Petitioner sold a part of his interest in the said partnership". In paragraph 5 (b) of his answer, the Commissioner stated "* * * it is admitted that the petitioner sold a fractional interest in the partnership known as Lehman Brothers".

[2] The fact that the Commissioner computed the capital gain in this manner is a strong indication that the Government at page 15 of its petition has exaggerated the importance of the matter.

ship assets and the length of time that they were held, was a capital asset.[3]

Having made the determination, described above, under subsection (b), the Commissioner determined that the holding period for the purpose of applying the percentage rates specified in subsection (a) of section 117 should be "measured from the date or dates of acquisition by the partnership of the specific partnership assets which the partnership owned at the date of sale of the fractional interest". (R. 3-4) It was this latter determination which the taxpayer placed directly in issue before the Tax Court. (R. 4)

Because of the Commissioner's original determination and the state of the pleadings, the Government is in the wholly untenable position on this record of having admitted that under subsection (b) the capital asset sold consisted of a fractional interest in a partnership distinct from the specific partnership assets, and of having to contend that under subsection (a) of section 117 the holding period should be measured, not from the date of the acquisition of the asset sold, but from the date or dates of acquisition by the partnership of the specific assets owned at the date of the sale. Because of this dilemma, the Government, by its basic specification of error, seeks to challenge in this Court the correctness of the Commis-

[3] The Commissioner's determination was in accordance with the theory of his own regulations. Article 113 (a) (13)-2 of Regulations 94 provides:

> "When a partner retires from a partnership, or the partnership is dissolved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. * * *"

This is a clear administrative recognition that the interest of a partner in a partnership is an asset distinct from his interest in the property of the firm, that it may be disposed of and that gain or loss may be computed thereon as in the case of any other asset. Substantially, the same regulation has been in effect since 1918. (See: *Helvering v. Walbridge*, 70 F. (2d) 683, 684 (C. C. A. 2))

sioner's original determination under subsection (b). That the taxpayer sold a capital asset which consisted of an interest in a partnership distinct from the specific partnership assets is not in issue in this case. Since the other matters raised in the petition for certiorari are admittedly subordinate to the basic specification of error (p. 16), the petition should be denied.

2. The property sold was a capital asset consisting of an intangible interest in a partnership distinct from the specific partnership assets.

Aside from the assertion that the issue specified is one of importance in the administration of the revenue laws, the Government states two grounds for the issuance of the writ: (1) that the decision below is in direct conflict with that of the Court of Claims in *City Bank Farmers Trust Company,* 47 F. Supp. 98 (1942); and (2) that the decision below is erroneous in holding that a partner has a property right in the partnership business which is distinct from his interest in the partnership assets and which may be the subject matter of a taxable transfer. These will be discussed in reverse order. The unimportance of the issue will appear from that discussion.

The Tax Court found as a fact that: "As of January 1, 1937, on the admission of new capital partners to Lehman Brothers, the petitioner * * * sold a fractional part of his property rights in the partnership * * *. The property rights sold by the petitioner to the buying partners constituted a fractional share of his interest in the partnership." In 1928, this Court in *Blodgett v. Silberman,* 277 U. S. 1, passed squarely upon the nature of such an interest. Specifically, it decided that Connecticut could include as part of the gross estate, for the purpose of the state inheritance tax, the value of the deceased's interest in a New York partnership, which, among other assets, owned New York real estate and tangible personal property which would not have been taxable if owned directly by the decedent. Speaking of the New York Partnership Law, Chief Justice Taft said:

"Under § 51 of this law, a partner is a co-owner with his partner of specific partnership property, holding this property as a tenant in partnership. Such tenancy confers certain rights with limitations. A partner has a right equal to that of his partners to possess specific partnership property for partnership purposes, but not otherwise. His right in specific partnership property is not assignable nor is it subject to attachment or execution upon a personal claim against him; upon his death the right to the specific property vests not in the partner's personal representative but in the surviving partner; his right in specific property is not subject to dower, curtesy, or allowance to widows, heirs or next of kin.

"Section 52 specifically provides:

'A partner's interest in the partnership is his share of the profits and surplus and the same is personal property.' "

* * * *

"It is very plain, therefore, that the interest of the decedent in the partnership of William Openhym & Sons was simply a right to share in what would remain of the partnership assets after its liabilities were satisfied. It was merely an interest in the surplus, a chose in action. It is an intangible and carries with it a right to an accounting." (pp. 10-11)

Thus, it is clear that this Court there held that a partner in a New York partnership has a property right in the business of the firm which is distinct from his interest in the partnership assets and which may be the subject of a taxable transfer.[4] Similarly, as early as 1928, the Board of Tax Appeals applied this principle in the application of the federal tax laws. (See: *Sam H. Harris,* 11 B. T. A. 871, 874-875 (1928), *aff'd,* 39 F. (2d) 546; *Henry Wilson,* 16 B. T. A. 1280, 1287 (1929)) In 1934, in *Helvering v. Walbridge,* 70 F. (2d) 683, which involved a question closely analogous to that presented here, the court below

[4] The court below assumed for the sake of argument that for federal tax purposes the Uniform Partnership Act in force in New York should be ignored. It reached the same conclusion "upon the basis of the law as it was before it was codified" as this Court reached in the *Blodgett* case. (R. 34-36)

held that property contributed by a partner became a firm asset, that the partner no longer had any effective power over it and, therefore, no interest in it "save as it might figure in 'his share of the profits and surplus' ". (p. 685) This Court denied the Government's petition for certiorari. (293 U. S. 594)

Likewise, with respect to the specific question raised here, as early as 1935 the Board of Tax Appeals in *Dudley T. Humphrey,* 32 B. T. A. 280, held that the sale of an interest in a New York partnership, the specific assets of which were non-capital in character, constituted the sale of a capital asset under section 101 of the Revenue Act of 1928. In so holding, the Board said:

> "Now, applying the above holdings to the present case, it would appear that what petitioner sold to his partners was an intangible consisting of his right to a share in the net value of the partnership after settlement of its affairs. He had no interest in the assets of the partnership as such; consequently, what he sold was not a portion of or an interest in the partnership securities. His interest in the partnership was separate and distinct from his coownership of the partnership assets and the length of time of his ownership of the partnership interest is not measurable by the period of time that the partnership had owned the securities on hand at the time he sold his interest. * * *" (pp. 283-284)

Though the issue was squarely presented in its broadest scope, the Commissioner merely noted his non-acquiescence (XIV-2 C. B. 34) but did not appeal. In 1940, the Board reaffirmed its position in *Morris Shapiro* (Memo. Dec., CCH Dec. 10,991(G)). The Government appealed but the Circuit Court of Appeals affirmed. (*Commissioner v. Shapiro,* 125 F. (2d) 532 (C. C. A. 6th, 1942)) In 1941, the United States District Court for the Eastern District of Pennsylvania in *Kessler v. United States,* 29 A. F. T. R. 1314, decided substantially the same issue in favor of the taxpayer. On appeal, the Circuit Court of Appeals reversed on other grounds *Kessler v. United States,* 124 F.

(2d) 152 (C. C. A. 3d, 1941). Later, the same question arising out of the same transaction as was involved in the *Kessler* case reached the Circuit Court of Appeals in the case of another partner in *Thornley v. Commissioner*, 147 F. (2d) 416 (C. C. A. 3d, 1945). The decision was in favor of the taxpayer. To the same effect are the decisions in *Stilgenbaur v. U. S.*, 115 F. (2d) 283 (C. C. A. 9th, 1940); *McClellan, et al, v. Commissioner*, 117 F. (2d) 988 (C. C. A. 2d, 1941); *Williams v. McGowan*, 152 F. (2d) 570 (C. C. A. 2d, 1945); *L. F. Long* (T. C. Memo Dec., 1947, CCH Dec. 15,840(M)); *Estate of Daniel Gartling* (T. C. Memo. Dec., 1947 CCH Dec. 15,945(M)); and *H. R. Smith*, 10 T. C. .... No. 49 (1948). See also: *Hill v. Commissioner*, 38 F. (2d) 165, 168 (C. C. A. 1st, 1930); *Adler, et al, v. Nicholas, et al*, ... F. (2d) .... (C. C. A. 10th), decided March 5, 1948 (CCH Par. 9205); *Robert E. Ford*, 6 T. C. 499 (1946); and *George Whitney*, 8 T. C. 1019 (1947).

Thus, the basic issue raised here has been decided adversely to the Government in principle by this Court in *Blodgett v. Silberman, supra*, and directly by the Tax Court in decisions dating back thirteen years, and in the meantime, by the Circuit Courts of Appeal for the Second, Third and Sixth Circuits. The decision below is in accord with the prevailing and elementary rule announced in these cases.

The decision below is consistent with the special treatment by Congress of partnerships for federal tax purposes. Had Congress intended to adopt the ancient common law concept of a partnership, there would have been no occasion for dealing with partnerships separately and in detail. (Secs. 181-188, Revenue Act of 1936) Those provisions are obviously inconsistent with the early common law concept. This Court in *Neuberger v. Commissioner*, 311 U. S. 83, pointed out that, "In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individ-

uals". (p. 88) (*Cf., Guaranty Trust Co. v. Commissioner,* 303 U. S. 493) The rule adopted by the Tax Court and the Circuit Court of Appeals is simpler from the standpoint of administration than that advocated by the Government. It is not suggested by the Government that the application of that rule adversely affects the revenue.

3. The decision of the Court of Claims in City Bank Farmers Trust Company, 47 F. Supp. 98 (1942), furnishes no substantial basis for the granting of the writ.

The primary reason advanced by the Government for the granting of the writ is the asserted conflict between the decision below and that of the Court of Claims in the *City Bank Farmers Trust Company case.* In that case, as in this, the sole question squarely presented was whether "when a partner sells his interest in a partnership business, the holding period for the purpose of applying the percentage rates specified in section 117 of the Revenue Act of 1936 * * * is to be measured from the date of the partner's acquisition of the partnership interest, or whether the holding period is to be measured from the date or dates of acquisition by the partnership of the specific partnership assets which the partnership owned at the date of sale of the partner's interest". (p. 103) On that question, the decision of the Court of Claims is in conflict with the decision below. However, on the basic error specified here, *i. e.,* the nature of the interest sold, it is implicit in the findings and opinion of the Court of Claims that the Commissioner in that case, as in this, determined that the interest sold was a capital asset distinct from the specific partnership assets. This is shown by the fact that the partnership there involved "was engaged in transacting a general brokerage business in stocks, bonds and other securities and commodities" (p. 99), and that in computing the capital gain, apparently no segregation was made between capital and non-capital assets (p. 101).

Thus, the statements of the Court of Claims, like those in the Government's petition here, to the effect that the interest sold was a prorata interest in specific assets, was contrary to the Commissioner's own determination and, therefore, irrelevant.

In any event, the reasoning of the Court of Claims that for federal tax purposes a partnership must be considered as an association of individuals who are vested with a direct pro-rata interest in the specific property of the firm conflicts in principle with the decision of this Court in *Blodgett v. Silberman, supra.* It is clearly out of harmony with the otherwise unbroken line of decisions by the Tax Court and by several Circuit Courts of Appeal dealing specifically with the capital gain and loss provisions of the federal revenue acts.

In reverting to the ancient common law concept that the property of a partnership is held not by the firm, but by the partners in common, the Court of Claims ignored the fact that long before the adoption of the Uniform Partnership Act by many of the states the early common law concepts had been modified so as to impound firm assets and to deprive individual partners of any control over them except in so far as they were dealing with them on behalf of the firm as a unit. (*Case v. Beauregard,* 99 U. S. 119 (1879). As the court below pointed out, the Uniform Partnership Act codified these modifications and made no substantial change when it declared in so many words that "a partner's interest in the partnership is his share of the profits and surplus" (R. 34-35), and "it was upon this traditional structure that Congress fitted the taxation of partnerships". (R. 34)

Over three years ago, the Circuit Court of Appeals for the Third Circuit in *Thornley v. Commissioner,* 147 F. (2d) 416 (1945), refused to follow the decision of the Court of Claims in the *City Bank Farmers Trust Company* case.

In spite of the conflict, the Government did not apply for certiorari. If the question were as important as the Government now asserts, it should have taken steps to resolve the conflict at that time. We submit that at this late date the decision of the Court of Claims should be regarded as an isolated and erroneous pronouncement with respect to an otherwise well-settled and elementary rule of law.

4. Under section 117 (a) of the Revenue Act of 1936, the holding period of a "capital asset" must be related to the time the asset sold was held by the taxpayer.

As we observed at the outset, this is really the only question in issue here. Once it is determined, as the Commissioner determined here and as the Tax Court and the court below agreed, that the asset sold consisted of an intangible, and not a pro-rata interest in specific partnership assets, it is too clear for argument that the holding period, under the precise terms of section 117 (a) must be related to the time the asset sold was held by the taxpayer and not to the time the assets of the partnership were held by the firm. Otherwise, it would be possible for a member of a partnership owning his interest for less than one year to have capital gain computed on the basis of the reduced percentages applicable to a holding period longer than that during which he held any interest in the firm.

5. In no event should the alternative issues be reviewed by this Court.

Arthur Lehman, one of the members of Lehman Brothers, died less than a year prior to the sale by the taxpayer of his fractional interest in the firm. The surviving partners, as they were entitled to do under the partnership agreement, continued the business. The Government contended that as a result of the death of Arthur Lehman a new partnership came into existence, which started a new holding period for the interests of the surviving partners. The contention was rejected both by the Tax

Court (R. 22-25) and by the Circuit Court of Appeals (R. 36-37). A related question was decided by this Court in *Heiner v. Mellon,* 304 U. S. 271, 277 (1938).

In deciding the issue, the Tax Court relied upon its previous decision in *Robert E. Ford,* 6 T. C. 499 (1946). In that case, the Tax Court rejected substantially the same contention made by the Commissioner concerning the effect of the withdrawal of a partner and the Commisisoner acquiesced. (1946—2 C. B. 2) In *Mary D. Walsh,* 7 T. C. 205 (1946), the Commissioner contended that the death of a partner terminated the "taxable year of the partnership" as that phrase is used in section 188 of the Internal Revenue Code. The Tax Court rejected the contention and the Commissioner again acquiesced. (1946—2 C. B. 5) Clearly, the analogous question raised here concerning the effect of the death of Arthur Lehman is of no public importance.

The Government also contended below that the taxpayer had not identified the fractional interest sold as having been held by him for more than ten years. This contention raised a question of fact, which the Tax Court resolved in favor of the taxpayer. (R. 19-22) Its decision thereon is entitled to the finality accorded such determinations by *Dobson v. Commissioner,* 320 U. S. 489. In any event, the narrow issue is peculiar to this case and not of general interest.

CONCLUSION

The basic question specified by the Government is not in issue before this Court. Further, the interest sold, which was admittedly a capital asset, consisted of a chose in action, an intangible interest in a partnership, and not a direct pro-rata interest in specific partnership assets. Despite the observations of the Court of Claims to the contrary, the principle is so universally recognized that at

this late date further clarification by this Court is unnecessary. Indeed, the reversal by this Court, at this late date, of a principle so firmly embedded in American tax law would create needless confusion. Further, if the question were as important as the Government now asserts, it should have appealed the decision of the Board of Tax Appeals in the *Humphrey* case in 1935 and have applied for certiorari at least three years ago in the *Thornley* case. The petition for certiorari should be denied. In no event should the alternative issues be reviewed by this Court.

Respectfully submitted,

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APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital asset has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of capital assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

New York Partnership Law, Chapter 39, Consolidated Laws of New York:

§ 50. *Extent of property rights of a partner.* The property rights of a partner are (a) his rights in specific partnership property, (b) his interest in the partnership, and (c) his right to participate in the management.

§ 51. *Nature of a partner's right in specific partnership property.* 1. A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

2. The incidents of this tenancy are such that:

(a) A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.

(b) A partner's right in specific partnership property is not assignable except in connection with the assignment of the rights of all the partners in the same property.

(c) A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them, or the representatives of a deceased partner, cannot claim any right under the homestead or exemption laws.

(d) On the death of a partner his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.

(e) A partner's right in specific partnership property is not subject to dower, curtesy, or allowances to widows, heirs, or next of kin.

§ 52. *Nature of partner's interest in the partnership.* A partner's interest in the partnership is his share of the profits and surplus and the same is personal property.